

**RULES
OF
DEPARTMENT OF REVENUE
INCOME TAX DIVISION**

**CHAPTER 560-7-3
SUBSTANTIVE RULES AND REGULATIONS**

560-7-3-.10 Interest Income on Government Obligations.

(1) Purpose. This Rule explains how to determine the interest expense related to interest and dividend income received on government obligations.

(2) General Rule. O.C.G.A. §§ 48-7-21 and 48-7-27 require Georgia taxpayers to add back or subtract interest and/or dividend income on certain United States, state, and local government obligations. Interest and/or dividend income is required to be added back if the obligations are subject to Georgia taxation, but were exempt federally and thus were excluded from federal gross income. Interest and/or dividend income must be subtracted if the obligations were taxable federally, but are exempt for Georgia purposes. In addition, certain adjustments must be made to reflect the fact that Georgia taxes this income net of related interest expense. In order to treat all government obligations consistently, the same formula is used to determine interest expense directly or indirectly attributable to the production of the interest or dividend income. The taxpayer's total interest expense is multiplied by a fraction to determine such direct and indirect interest expense. The numerator of the fraction is the total of the average adjusted bases of the obligations at issue, and the denominator is the total of the average adjusted bases for all assets of the taxpayer.

(3) Interest on Obligations of Other States or Their Political Subdivisions; Addition. Interest income received on obligations of any state other than Georgia or on obligations of political subdivisions of such other states must be added back to federal

taxable income when calculating Georgia taxable income to the extent such interest was not included in gross income for federal income tax purposes. If any related interest expenses were not deducted from federal taxable income, then the addition shall be reduced by the direct or indirect interest expenses attributable to such income. The following formula shall be utilized to determine such direct and indirect interest expense. The total interest expense shall be multiplied by a fraction, the numerator of which is the total of the taxpayer's average adjusted bases of the obligations at issue, and the denominator of which is the total of the average adjusted bases for all assets of the taxpayer. For example:

Taxpayer has \$3,000 of interest income which is exempt from federal income tax, but which is subject to Georgia taxation because the interest derives from obligations of states other than Georgia. The \$3,000 must be added back, but the taxpayer is allowed to subtract the related interest expense from the \$3,000 so that it is properly taxed on a net income basis. The total interest expense for the taxpayer is \$100,000. The total of the average adjusted bases for the obligations at issue is \$60,000, and the total of the average adjusted bases for all of the taxpayer's assets is \$24,000,000. The fraction of \$60,000 over \$24,000,000 yields 0.25%. Applying 0.25% to the \$100,000 total interest expense yields related interest expense of \$250. The \$3,000 addback is thus reduced by the \$250 of related interest expense, resulting in a net figure of \$2,750 of interest income that must be added back to the Georgia tax base.

$$\begin{aligned} & \$3,000 - [\$100,000 \times \$60,000/\$24,000,000] = \\ & \$2,750 \text{ added back to the Georgia tax base} \end{aligned}$$

(4) Interest or Dividends on Obligations Exempted from Federal Income Tax But Not From State Income Tax; Addition. Interest or dividends received on certain federal obligations which are exempt from federal income tax but not from state income tax must be added to taxable income. If any related interest expenses were not deducted from federal taxable income,

then the addition shall be reduced by the direct or indirect interest expenses attributable to such income. The following formula shall be utilized to determine such direct and indirect interest expense. The total interest expense shall be multiplied by a fraction, the numerator of which is the total of the taxpayer's average adjusted bases of the obligations at issue, and the denominator of which is the total of the average adjusted bases for all assets of the taxpayer. For example:

Taxpayer has \$20,000 of interest income which is exempt from federal income tax, but which is subject to Georgia taxation. The interest income derives from federal obligations which are exempt from federal income tax but which are not exempt from state income tax. The \$20,000 must be added back, but the taxpayer is allowed to subtract the related interest expense from the \$20,000 so that it is properly taxed on a net income basis. The total interest expense for the taxpayer is \$50,000. The total of the average adjusted bases for the obligations at issue is \$400,000, and the total of the average adjusted bases for all of the taxpayer's assets is \$4,000,000. The fraction of \$400,000 over \$4,000,000 yields 10%. Applying 10% to the \$50,000 total interest expense yields related interest expense of \$5,000. The \$20,000 addback is thus reduced by the \$5,000 of related interest expense, resulting in a net figure of \$15,000 of interest income that must be added back to the Georgia tax base.

$$\begin{aligned} & \$20,000 - [\$50,000 \times \$400,000/\$4,000,000] = \\ & \$15,000 \text{ added back to the Georgia tax base} \end{aligned}$$

(5) Interest or Dividends on United States Obligations; Subtraction. Interest or dividend income received on United States obligations which is included in gross income for federal income tax purposes, but which is exempt from state income taxes under federal and Georgia law, must be subtracted from taxable income. Any direct or indirect interest expenses attributable to such income shall first be applied to determine the correct amount to be subtracted. The following formula shall be utilized to

determine the direct and indirect interest expense. The total interest expense shall be multiplied by a fraction, the numerator of which is the total of the taxpayer's average adjusted bases of the obligations at issue, and the denominator of which is the total of the average adjusted bases for all assets of the taxpayer. For example:

Taxpayer has \$10,000 of interest income from United States obligations which is taxable for federal income tax purposes, but which is exempt from Georgia taxation. The interest income must be subtracted from the Georgia tax base, but the taxpayer must first subtract the related interest expense from the \$10,000 so that only the net interest income is removed from the base; otherwise the related interest expense will shield unrelated income from Georgia taxation. The total interest expense for the taxpayer is \$100,000. The total of the average adjusted bases for the obligations at issue is \$200,000, and the average adjusted bases for all of the taxpayer's assets is \$10,000,000. The fraction of \$200,000 over \$10,000,000 yields 2%. Applying 2% to the \$100,000 total interest expense yields related interest expense of \$2,000. The \$10,000 of interest income is thus first reduced by the \$2,000 of related interest expense, resulting in a net figure of \$8,000 of interest income that must be subtracted from the Georgia tax base.

$$\begin{aligned} & \$10,000 - [\$100,000 \times \$200,000/\$10,000,000] = \\ & \$8,000 \text{ subtracted from the Georgia tax base} \end{aligned}$$

Authority: O.C.G.A. §§ 48-2-12, 48-7-21 and 48-7-27.